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May 5, 2004

Mary L. Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, Massachusetts 02110

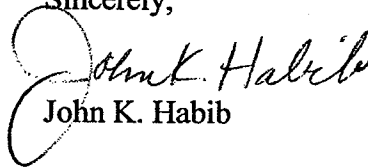
Re: Southern Union Company, D.T.E. 04-36

Dear Secretary Cottrell:

Enclosed please find the Post Hearing Comments of Southern Union Company in the above-referenced proceeding. Please do not hesitate to contact me if you have any questions or if I can provide you with any additional information.

Thank you for your attention to this matter.

Sincerely,



John K. Habib

Enclosures

cc: Andrew O. Kaplan, General Counsel
Elizabeth Cellucci, Hearing Officer
James Powell, Analyst
Glenn Shippee, Analyst
Meera Bhalotra, Analyst
Joseph Passaggio, Analyst

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Southern Union Company

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D.T.E. 04-36

POST HEARING COMMENTS OF SOUTHERN UNION COMPANY

Submitted by:

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Dated: May 5, 2004

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Southern Union Company)
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D.T.E. 04-36

POST-HEARING COMMENTS OF SOUTHERN UNION COMPANY

I. INTRODUCTION

On March 16, 2004, Southern Union Company ("Southern Union" or the "Company") filed a petition with the Department of Telecommunications and Energy (the "Department") for approval and authorization pursuant to G.L. c. 164, § 14 to: (1) enter into a long-term \$400 million revolving credit agreement (the "RCA") providing borrowing capacity up to \$230 million beyond the Company's recently authorized long-term debt issuance; and (2) issue up to \$130 million in common stock for the purpose of refinancing outstanding debt and improving the Company's debt-to equity capital ratio. The Department docketed the proceeding as D.T.E. 04-36. There were no intervening parties in the proceeding.

On April 26, 2004, the Department conducted public and evidentiary hearings at its offices. At the evidentiary hearing, the Company presented one witness: Richard N. Marshall, Vice President and Treasurer of Southern Union, who testified in support of the Company's request for authorization to enter into the RCA and issue up to \$130 million in common stock. In addition to the sworn testimony presented at the hearing, the evidentiary record consists of approximately 28 documentary exhibits, including the initial filing and the Company's responses to information requests.

As discussed herein, the record in this proceeding shows that the Company has met the Department's two-part standard under G.L. c. 164, §§ 14 for the approval and

authorization to enter into the RCA and to issue up to \$130 million in common stock in that: (1) the financing is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations and (2) the Company has met the net-plant test. Accordingly, the Department should approve the Company's request in this proceeding.

II. DESCRIPTION OF THE PROPOSED FINANCING

A. The RCA

The Company proposes to enter into a three to five-year RCA providing up to \$400 million of borrowing capacity to meet seasonal working capital needs, to fund ongoing utility operations, and to support other general utility purposes (Exh. SU-1, at 4). The proposed \$400 million revolving credit facility will replace two existing revolving credit facilities, which are: (1) a \$150 million revolving credit facility that matured on April 1, 2004 (Exh. SU-DTE-1-3); and (2) a \$225 million credit facility that expires on May 29, 2004 (*id.*). As of April 22, 2004, the Company had no borrowings outstanding under the latter credit facility and the Company does not anticipate the need to borrow under such agreement prior to its expiration on May 29, 2004 (*id.*). However, the Company does anticipate needing to draw on the new facility now pending before the Department by the end of May 2004. (*id.*)

The RCA will allow the Company to enter into a long-term debt obligation of approximately \$230 beyond the Company's recently authorized debt issuance (Exh. SU-1, at 2). The Company requires authorization for only \$230 million of this amount because the Department recently authorized the Company to issue up to \$400 million in long-term debt in Southern Union Company, D.T.E. 03-64 (2003) (*id.* at 3). Pursuant to

that authorization, the Company issued \$230 million in preferred securities in October 2003 (id.). Rather than issue the remaining \$170 million in senior notes or preferred securities, the Company has decided to enter into a three to five-year revolving credit agreement that would provide up to \$400 million of borrowing capacity to finance ongoing utility operations and gas purchases made on behalf of customers (id.). Therefore, the Company is seeking authorization to incur an additional \$230 million in long-term debt obligations beyond the amount authorized in D.T.E. 03-64 (id.). Borrowings under the new \$400 million facility would be used to provide funding for local distribution company operations, including the seasonal working capital needs of the Company (id. at 3, 4).

The Company anticipates that the interest rate associated with the new credit facility will be based on the prime rate and the London Interbank Offering Rate ("LIBOR") (id. at 5; Exh. SU-DTE-1-2). Based on the Company's current credit ratings, the credit spread over LIBOR is anticipated to be 0.75 percent (Exh. SU-DTE-1-2). Based on current LIBOR rates, and assuming LIBOR rates increase by no more than 1 percent on average in each of the five years covered by the revolving credit agreement, interest rates would range between approximately 1.85 and 7.00 percent (id.; Exh. SU-DTE-1-4).

The prime rate will be applicable to overnight borrowings, if any, and would be calculated on the basis of a 365 or 366-day year, when applicable, for the actual days elapsed and will be payable in arrears (Exh. SU-1, at 5). Interest in relation to any LIBOR-based borrowings would be computed on the basis of a 360-day year for the actual days elapsed (id.). LIBOR-based borrowings are expected to be available for

periods of 30, 60, 90 and 180 days and it is expected that interest will be payable on the last day of each maturing period (id.; Exh. SU-DTE-1-2).

In the event the Company utilizes the LIBOR-based borrowing option, the interest charged to the Company will be calculated at a credit spread over the LIBOR rate based on the Company's senior secured long-term debt ratings by Standard & Poor's and Moody's Investor Service (Exh. SU-1, at 5; Exh. SU-DTE-1-5). The Company's senior secured long-term debt is currently rated BBB by S&P and Baa3 by Moody's (id.) The Company anticipates closing the RCA within 10 to 14 days following the Department's decision in this proceeding (Exh. SU-DTE-1-7).

B. The Stock Issuance

The Company is also requesting in this proceeding authorization to issue common stock with an aggregate market value of up to \$130 million (Exh. SU-1, at 6). The Company has not yet determined the timing or pricing of the stock issuance (id.). Southern Union's Executive Committee of the Board of Directors voted on the proposed issuance on March 15, 2004 (id.; Exh. SU-2). Southern Union's Executive Committee of the Board of Directors has also authorized the Company to file an Omnibus Shelf Registration on Form S-3 to issue and sell up to \$1 billion in debt and equity securities, under which this common stock issuance would be covered (Exh. SU-1, at 7).

The proceeds from the stock issuance will be used to repay long-term debt in order to maintain and enhance the Company's financial position through the achievement of a more favorable debt-to-equity ratio (id.; Exh. SU-DTE-1-10). This recapitalization from debt to equity is consistent with the Company's utility-service obligations (Exh. SU-1, at 7).

III. CAPITAL STRUCTURE OF THE COMPANY

As of December 31, 2003, Southern Union's utility plant (including \$119,132,000 in construction work in progress ("CWIP")) was \$3,414,164,000 (Exh. SU-DTE-1-13(a)). After removing \$698,858,000 in accumulated depreciation, the Company's net utility plant was \$3,183,310,000 (id.). As of December 31, 2003, the Company also had \$230,854,000 in gas inventories (id.). Accordingly, as of December 31, 2003, the Company had a net utility plant and gas inventory balance of \$3,414,164,000 (id.). Also as of December 31, 2003, the Company's total capitalization was \$3,441,639,000, consisting of: (1) \$2,370,137,000 in long-term debt (including \$230,000,000 of preferred securities); and (2) \$946,502,000 in common equity, which included a retained earnings balance of \$47,567,000 (id.).

Consistent with Department precedent, the Company made a number of pro forma adjustments to its consolidated balance sheet for the purpose of comparing the post-issuance net-utility plant to total capitalization. First, the Company excluded \$22,708,000 (plant-in-service of approximately \$16,909,000, less accumulated depreciation of approximately \$2,374,000, plus gas inventories of \$8,173,000), from net plant in service to remove plant associated with unregulated operations (id.). The Company also eliminated \$119,132,000 in CWIP from its property, plant and equipment accounts (id.). As a result of these adjustments, the Company's property, plant and equipment amounted to \$3,272,324,000 (id.).

The Company then made corresponding adjustments to its capitalization. First, the Company reduced its total capitalization by \$14,535,000 associated with unregulated operations, based on a pro-rata reduction to long-term debt, preferred securities, and premiums on common stock (id.) Second, the Company excluded \$642,921,000

associated with goodwill recorded on the Company's books, representing the excess of the purchase prices over book value of several natural gas utilities acquired in recent years (id.). Third, the Company excluded from capitalization retained earnings of approximately \$47,567,000 (id.). As a result of these adjustments, the Company's total capitalization as of December 31, 2003 amounted to \$2,736,616,000 (id.).

IV. STANDARD OF REVIEW

For the Department to approve the issuance of stock, bonds, coupon notes or other types of long-term indebtedness by an electric or gas company, the Department must determine that the proposed issuance satisfies two requirements. First, the Department must assess whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Boston Edison Company, D.T.E. 00-62, at 2 (2000); Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test. Colonial Gas Company, D.P.U. 84-96 (1984).¹

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities,

¹ The net plant test is derived from G.L. c. 164, § 16.

319 Mass. 46, 52 (1946). In cases where no issue exists about the reasonableness of management decisions regarding the requested financing, the Department limits its § 14 review to the facial reasonableness of the purpose to which the proceeds of the proposed issuance will be put. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

V. THE COMPANY'S PROPOSAL MEETS THE DEPARTMENT'S STANDARDS OF REVIEW UNDER G.L. c. 164, §§ 14 and 16.

A. The Company Has Demonstrated That the Proposed Financing Is Reasonably Necessary to Accomplish a Legitimate Utility Purpose.

The record demonstrates that the Company's proposed financing is reasonably necessary to accomplish a legitimate purpose in meeting the company's service obligations. First, the RCA is reasonably necessary in order to allow the Company to finance its ongoing utility operations, including gas purchases, at favorable rates (Exh. SU-1, at 3, 4). In addition, the Company's proposed issuance of common stock will serve a legitimate utility purpose in that it will allow the Company to repay long-term debt, and thus, help the Company improve its debt-to-equity ratio, improve overall borrowing liquidity and help to ensure that the Company is able to maintain its investment grade rating for financial purposes (*id.* at 3). Therefore, the Company's proposed financing meets the first prong of the Department's two-part standard.

B. The Company Has Demonstrated That Its Net Utility Plant Will Exceed Its Total Capitalization Following the Financing.

As discussed above, the Company has demonstrated (consistent with the requirements of the Department's net-plant test) that its net utility plant equals or exceeds its total capitalization and will continue to do so following the proposed issuance, pursuant to G.L. c. 164, § 16. See New England Power Company, D.T.E. 00-53, at 10 (2000); Boston Edison Company, D.T.E. 00-62, at 9-10 (2000). Southern Union Company, D.T.E. 03-46 (2003). Therefore, the Department should authorize and approve the Company's request to: (1) enter into the RCA; and (2) issue up to \$130 million in common stock.

As part of its demonstration that it meets the Department's net-plant test, the Company made a number of adjustments to its consolidated balance sheet as of December 31, 2003. First, the Company excluded CWIP from its plant investment balance and to exclude retained earnings from the Company's plant and capitalization accounts for purposes of its net plant test calculation (Exh. SU-DTE-1-13(a)), consistent with Department precedent. See Southern Union Company, D.T.E. 03-64, at 9 (2003); Southern Union Company, D.T.E. 01-52, at 9; New England Power Company, D.P.U. 92-189, at 7 (1992); Colonial Gas Company, D.P.U. 84-96, at 8 (1985).

The Company also excluded from Property, Plant and Equipment, the net property, plant and equipment relating to its unregulated business operations, consistent with Department precedent. Southern Union Company, D.T.E. 03-64, at 9 (2003); NYNEX Price Cap, D.P.U. 94-50, at 440 (1995); Colonial Gas Company, D.P.U. 84-94, at 51 (1984). Specifically, the Company excluded \$22,708,000 (plant-in-service of approximately \$16,909,000, less accumulated depreciation of approximately \$2,374,000,

plus gas inventories of \$8,173,000), from net plant in service to remove plant associated with unregulated operations (Exh. SU-DTE-1-13(a)).

Also consistent with Department precedent, the Company adjusted the net-plant-test calculation to exclude the net goodwill totaling \$642,921,000 from the Company's overall capitalization (id.); See Southern Union Company, D.T.E. 03-3, at 20 (2003)). Over the past several years, the Company completed a number of acquisitions of regulated natural gas companies. The net goodwill of \$642,921,000 reflects the excess of the purchase prices of the acquired companies over the book value of the assets acquired (Exh. SU-1, at 11). Thus, the Company reduced its total capitalization by \$642,921,000 to reflect the removal of the net goodwill from the net-plant-test calculation (Exh. SU-DTE-1-13(a)). This is consistent with the Department's treatment of additional purchase costs in previous cases presented by Southern Union and with prior Department precedent. See e.g., Southern Union Company, D.T.E. 03-64, at 10 (2003) Southern Union Company, D.T.E. 03-46, at 13 (2003); Southern Union Company, D.T.E. 03-3, at 20 (2003); New England Power Company, D.T.E. 00-53, at 8-9 (2000).

The Company also demonstrated that the Company's net-plant in service will exceed its capitalization assuming that: (1) the Company issues a total of \$130 million in common stock; and (2) the \$400 million revolving credit facility is fully drawn at the time of issuance. Specifically, the Company adjusted its common stock assuming a sale of approximately 6.5 million shares at \$20 per share (\$130 million), and increasing Common Stockholders' Equity in the par value amount of \$6,500,000 and an increase of \$123,500,000 to Premium on Capital Stock (Exh. SU-DTE-1-13(b)).

In addition, the Company increased long-term debt obligations by \$400 million to reflect the addition of the revolving credit agreement, even though the Company will not maintain a balance on that arrangement up to the maximum except on a temporary basis (id.). The analysis assumes that the Company will use the first \$31.9 million of the revolving credit line to repay existing debt (id.). As demonstrated in Exhibit SU-DTE-1-13(b), the Company's net-plant in service exceeds capitalization by approximately \$166,795,000, following the issuance of \$130 million in common stock and \$400 million in revolving credit debt.

Thus, as demonstrated by the record, the Company's net-plant in service exceeds capitalization by approximately \$166,795,000 following the issuance of \$130 million in common stock and \$400 million in a revolving credit debt. Accordingly, the Company has met the second prong of the Company's two-part standard.

VI. CONCLUSION

The record in this proceeding shows: (1) that the Company's proposed financing involving: (1) entering into the RCA; and (2) issuing up to \$130 million of common stock is reasonably necessary to meet the Company's service obligations; and (2) that the Company's net-utility plant equals or exceeds its total capitalization (as calculated consistently with the Department's precedent on the net-plant test) and will continue to do so following the proposed financing. Therefore, for the reasons stated above, the Department should:

VOTE: That entering into the long-term \$400 million revolving credit agreement is reasonably necessary for a legitimate purpose in meeting the Company's service obligations, pursuant to G.L. c. 164, § 14.

VOTE: That entering into the long-term \$400 million revolving credit agreement is in accordance with G.L. c. 164, § 16, in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company, will exceed its outstanding stock and long-term debt.

VOTE: That issuing up to \$130 million in common stock is reasonably necessary for a legitimate purposes in meeting the Company's service obligations, pursuant to G.L. c. 164, § 14.

VOTE: That issuing up to \$130 million in common stock is in accordance with G.L. c. 164, § 16, in that the fair structural value of the Company's property, plant and equipment and the fair value of the gas inventories held by the Company, will exceed its outstanding stock and long-term debt.

ORDER: That the Department approves and authorizes the Company to enter into the long-term revolving credit agreement described herein.

ORDER: That the Department approves and authorizes the issuance and sale by Southern Union Company, in conformity with all the provisions of law relating thereto, of common stock with an aggregate value of up to \$130 million.

ORDER: Such other and further orders and approvals as may be necessary or appropriate.

Respectfully submitted,

SOUTHERN UNION COMPANY

By its attorneys,


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Dated: May 5, 2004